SUPREME COURT, U. S.
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No. 18

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

UTAH PIE COMPANY, *Petitioner,*

v.

CONTINENTAL BAKING COMPANY, CARNATION COMPANY, and PET MILK COMPANY, *Respondents.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

PETITION OF CONTINENTAL BAKING COMPANY FOR REHEARING

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PETITION OF CONTINENTAL BAKING COMPANY FOR REHEARING

Respondent Continental Baking Company ("Continental") respectfully petitions the Court for rehearing, or reconsideration of the decision announced in this cause on April 24, 1967, holding that a Continental area price difference violated Section 2(a) of the amended Clayton Act.

This petition is addressed solely to the question of the legal significance apparently given by the Court to an everyday competitive fact—sales below fully distributed cost. The references in the majority opinion to sales below cost are not defined, nor is there discussion of their legal relevance. As a precedent for the

future they have obvious anticompetitive potential which is completely unfounded in prior judicial and economic analysis.

The Majority Opinion as Precedent Overturns All Prior Judicial and Economic Analysis of Selling Below Cost

In terms of Continental Baking Company, the opinion refers to the fact that Continental's two week price in Salt Lake City "was less than its direct costs plus an allocation for overhead." 35 U.S.L.W. 4373, 4376 (U.S. April 24, 1967). The opinion later refers to "persistent sales below cost," *Id.* at 4378, fn. 14, and distinguishes a Federal Trade Commission decision on the ground of "absence of sales below cost." *Id.*, fn. 15.

The Court's reliance upon isolated sales below fully distributed cost will be understood as the key to the holding against Continental. References in the majority opinion to "drastic" price reductions, "persistent" sales below cost, and "erosion" of prices during a four-year period will not be read to apply to Continental. The Court's own statement of the facts recognizes that the case against Continental was only a two-week case in which Continental offered a price that was the arithmetic equivalent of the price being charged by the dominant seller[1] and that had no more than a negligible impact on the plaintiff. *Id.* at 4376-77. The only apparent basis in the facts for the decision against Continental is that Continental could lawfully be found to be "predatory" solely because it sold below its fully allocated fixed cost for two weeks, and then offered to do so for another two-week period.

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[1] The majority also refers to Continental's problems of cost in 1958-1960, but recognizes that its sales were infinitesimal in these years. *Id.* at 4376.

The Court's holding as to Continental thus is that (1) sales below cost are sufficient to permit a finding of predatory intent without any other evidence of motive and, (2) that this inference is legally acceptable even as to sales which more than recover a seller's direct costs and are below cost only in the sense they do not recover all of a firm's fixed allocable costs.

No precedent exists for this restriction on price competition. In its recent decision in *United States* v. *National Dairy Prods. Co.*, 372 U.S. 29, 36-37, the Court was careful to state:

> "This opinion is not to be construed, however, as holding that every sale below cost constitutes a violation of § 3. Such sales are not condemned when made in furtherance of a legitimate commercial objective, such as the liquidation of excess, obsolete or perishable merchandise, or the need to meet a lawful, equally low price of a competitor. 80 Cong. Rec. 6332, 6334; see Ben Hur Coal Co. v. Wells, 242 F.2d 481 (C.A. 10th Cir. 1957). Sales below cost in these instances would neither be 'unreasonably low' nor made with predatory intent."

This ruling of law has now been disregarded. The fact that the *National Dairy* case arose under Section 3 of the Robinson-Patman Act quite obviously is not a distinguishing fact. The basic question in that case and here is whether sales below cost are themselves unreasonable.[1] Moreover, while in this case the

[1] In FTC v. Anheuser-Busch, Inc., 363 U.S. 536, 552, the Court said, "it might be argued that a price reduction below cost tends to establish such [a predatory] intent." This passing and very general reference—not distinguishing between direct and fully distributed cost—was not a prior holding that, whatever the circumstances, a showing of sales below any concept of cost is sufficient to take a case to a jury on unlawful intent. Indeed, the Court made it clear it was expressing no such view. 363 U.S. at 553.

Court has apparently held without discussion that sales below fully distributed cost are themselves sufficient evidence of predatory intent, in *National Dairy* the Court studiously refused to decide on the legal difference between sales below "direct" cost and sales below "fully distributed" cost. The indictment in *National Dairy* charged sales below direct cost with an anti-competitive purpose.

The Government has exhibited a similar informed caution as to what below cost selling proves. Its Brief in *National Dairy* explicitly recognized that sales below cost may have justifiable motivations including that "they may be made to introduce a new product or to break into a new market." Brief for Appellant at 11; Brief for Appellant on Reargument at 30-31, 41-42, *United States* v. *National Dairy Prods. Co., supra.* Its consent orders which enjoin sales below cost do so only when such sales are shown to be coupled with an intent to injure competition. See *e.g., United States* v. *Western Newspaper Union,* 1960 CCH Trade Cas. ¶ 69,709 (S.D.N.Y. 1960); *United States* v. *Safeway Stores, Inc.,* 1957 CCH Trade Cas. ¶ 68,871 (N.D. Texas 1957); *United States* v. *Ekco Prods. Co.,* 1957 CCH Trade Cas. ¶ 68,768 (N.D. Calif. 1957).

The lower courts have concluded that sales below cost do not by themselves provide a basis for a finding of illegality. These courts recognize that an inference of predatory intent can rationally be drawn only if losses incurred are extreme in amount, sustained in duration, and lacking in competitive compulsion. See, *e.g., Borden Co.* v. *FTC,* 339 F.2d 953 (7th Cir. 1964); *Ben Hur Coal Co.* v. *Wells,* 242 F.2d 481 (10th Cir. 1957), *cert. denied,* 354 U.S. 910; *United States* v. *Aluminum Co. of America,* 148 F.2d 416, 438 (2d Cir.

1945); *Union Leader Corp.* v. *Newspapers of New England, Inc.*, 180 F. Supp. 125, 143 (D. Mass. 1959), *modified*, 284 F.2d 582 (1st Cir. 1960), *cert. denied*, 365 U.S. 833.

The Federal Trade Commission has also held that discriminatory sporadic below cost sales by themselves are no sufficient basis for finding a violation of Section 2(a). See, *e.g.*, *Dean Milk Co.*, FTC Dkt. 8032 (Oct. 22, 1965); *International Milling Co.*, FTC Dkt. 7136 (Nov. 6, 1963); *cf.*, *Quaker Oats Co.*, Dkt. 8112 (Nov. 18, 1964).[1]

There Are Many Justifiable Reasons for Selling Below Fully Distributed Cost

While, as noted, the courts have previously suggested than an inference of predatory intent can be drawn from excessive losses sustained over a long period with no justification established, it is perfectly obvious that there are a number of situations in which temporary selling below cost and, particularly, selling below fully distributed cost, is justifiable. These include:

(i) Introduction of a new product which consumers and distributors must be educated to accept.

(ii) Entry into a new market area where the seller's brand lacks consumer acceptance.

(iii) Necessity of providing customers with a full line, including some low volume products.

(iv) Inability to estimate accurately elasticity of demand.

[1] In *Quaker Oats* the hearing examiner found that the challenged sales were below fully distributed cost and therefore were unlawfully low. Initial Decision, 72-77 (Oct. 21, 1963). In reversing, the Commission thus plainly held, albeit *sub silentio*, that such below cost sales were not unlawful.

(v) Unexpected failure of merchandising programs to generate sales sufficient to cover their costs.

(vi) Unexpectedly high costs of production due to strikes, shutdowns, increased raw materials costs, reduced production runs due to declining sales volume, and the like.

(vii) Necessity of disposing of excess or obsolete inventory.

(viii) Meeting competition in good faith.

(ix) Reduction of price to increase volume and maximize profit.

(x) One seller temporarily unable to achieve costs as low as his competitors.

For these reasons sales below fully distributed cost do not by themselves afford a rational basis for finding predatory intent. They are simply a neutral fact.

The necessity, and indeed the desirability, of below cost selling in various circumstances is fully endorsed in the economic literature. See *e.g.*, J. Dean, *Cost Forecasting and Price Policy,* 13 J. MARKETING 279, 286 (1949); *Management Curbs Costs, Pushes Sales to Stay in Black,* READINGS IN CURRENT ECONOMICS 26 (1958); T. Wentz, *Realism in Pricing Analyses,* J. MARKETING 19 (April, 1966); *cf.*, C. Edwards, MAINTAINING COMPETITION 9 (1949); P. Samuelson, ECONOMICS 519 (2d ed. 1952).

The economic fallacy of a judicial condemnation of sales below fully distributed cost was ably stated by Richard M. Lovell:

"The beguilingly simple proposition that prices should provide for the producer's cost may seem

sound upon its face; given the equilibrium assumptions of supply and demand economics, prices over the long run should indeed tend to allow for the total costs of all producers, and for competitive profits as well. But this equilibrium exists only in the long run, when all resources are properly allocated in accordance with productivity. It is not intended to be a norm for day-to-day pricing policy. In the short run, the way in which resources are in fact to be guided by the market to their most economic uses is precisely by prices which are either *above* cost (thus attracting more resources to the short areas), or *below* costs (thus tending to drive resources out of the less economic areas). Prices in the short run are thus governed primarily by demand factors—consumers' choices among alternative ways of spending their money. Independent producers adjust to such market prices as best they may in the light of their internal cost conditions, carrying forward production so long as marginal revenue exceeds marginal cost. The idea of freezing prices at the level of cost prevents the market from performing its chief social function—guiding the allocation of resources according to criteria of productivity and consumer demand." *Sales Below Cost Prohibitions: Private Price Fixing Under State Law,* 57 YALE L. J. 391, 396-398 (1948)

Frederick M. Rowe in his definitive work on the Robinson-Patman Act includes a statement of the same point:

"Under any but classic monopoly conditions, industrial prices are coalesced from manifold considerations, with 'cost' only part of the panorama of the market where competitive and strategic factors loom uppermost. To be sure, the secure monopolist—a 'public utility' sheltered by the Government from competition, or a member of a price-fixing conspiracy whose participants have

made their peace with or without a Government assist—may retain plenary power to fix his prices on the basis of 'cost.' But sellers exposed to market forces must quote prices responsive to the pressures of demand and competition. Notwithstanding apologetic public announcements for price hikes, their prices are *not* really set by cost; indeed, prices—which influence sales, hence production volume, in turn governing the efficiency of the firm's plant utilization—may *determine* the unit cost of the output more directly than vice versa." [Footnotes omitted] Rowe, PRICE DISCRIMINATION UNDER THE ROBINSON-PATMAN ACT 305-306 (1962).

To Impart Controlling Legal Significance to Sales Below Allocated Cost Would Be Both Unworkable and Discriminatory

A legal test of area price differences based upon a comparison of the low price to fully distributed cost would be wholly unworkable. There is no agreed definition of "cost" nor agreed basis of allocation. Rational allocation of costs is particularly impossible in a multi-product company. J. Dean, *Cost Forecasting and Price Policy,* 13 J. MARKETING 279, 287 (1949); C. Edwards, PRICE DISCRIMINATION 591, 596-597 (The Brookings Institution, 1959). Both of the federal enforcement agencies, in opposing legislation which would outlaw sales below cost, have stressed the imprecise nature of the "cost" concept. *Hearings on H.R. 10235 Before the House Interstate and Foreign Commerce Committee,* 86th Cong., 2d Sess., 4-7 (1960). According to the Department of Justice, "The cost of manufacturing, of packaging, of selling, not to mention overhead cost, are all imprecise terms as to the meaning of which there will no doubt be disagreement." *Hearings, supra* at 7. This Court itself has commented on "the intricacies inherent in the attempt to show

costs" and on the "elusiveness of cost data, which apparently cannot be obtained from ordinary business records . . . ." *Automatic Canteen Co.* v. *FTC*, 346 U.S. 61, 68.

Such a test of legality would also be irrational in concept and discriminatory in application. Fixed costs include such "costs" as depreciation and advertising. A firm with new plant and equipment, for instance, has a higher depreciation "cost" than does a firm with older capital investment. A similar price reduction in a market by both firms might bring the price below the fully allocated cost of the firm with the newer equipment, but leave it above the total cost of the other firm. Plainly the law cannot be that a jury may find that the firm with the higher depreciation "cost" on its books violated Section 2(a) while the other did not. Similarly, such a rule would condemn pricing decisions by a firm with high advertising expense which a firm with no investment in advertising could freely make. The fact of the matter is, of course, that many of these "costs" are not costs at all in the normal sense. They are expense items having relevance largely only in terms of deductions against current income for tax purposes. There is no commercial reason for ineluctably tying pricing decisions to these accounting concepts.

A rule that discriminatory selling below total cost is sufficient proof of a Section 2(a) violation would also have different impact in different industries, again for no logical reason. For instance, such a rule would forbid all promotional pricing in the food industry where competition keeps profits down to about two per cent of sales. However in other industries, such as cosmetics, where profits are considerably higher, sub-

stantial promotional price reductions would be permitted.

There is no discernible social value in eliminating promotional pricing in all, or some, industries. The Court must recognize that the pricing decisions of responsible business enterprises are not made in the light of a guess as to what a jury might do but on the basis of the necessity of avoiding conduct that can expose a company to the *risk* of an adverse jury verdict. Thus, the impact on competition of the Court's decision against Continental will be far more substantial than any narrow reading of the opinion might indicate.

CONCLUSION

The decision as to Continental represents a radical extension of the law which goes to the heart of the price mechanism. Unlike most other important antitrust decisions, the Court in this instance has not had the views of the enforcement agencies presented to it. For these reasons Continental suggests the Court may find it appropriate to request the views of the Solicitor General. We submit the Court should consider the issue further, desirably in the light of comments from the Solicitor General, before leaving the holding as to

below cost selling that the decision as to Continental signifies.

Respectfully submitted.

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Certificate

This is to certify that the foregoing PETITION FOR REHEARING is presented in good faith and not for purposes of delay.

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19 May 1967